

Hong Kong's Developing Double Tax Agreement (DTA) Regime: A Case Study of the HKSAR-New Zealand DTA

Professor Adrian Sawyer

Acting Pro-Vice-Chancellor and Dean of Commerce
College of Business and Economics
University of Canterbury

Media Reporting

APPENDIX 2: National Business Review article dated 29 October 2010

Hong Kong tax treaty to boost investment in New Zealand

Niko Kloeten

Double taxation treaty talks between New Zealand and Hong Kong will make investing in New Zealand more attractive and will also help Kiwi companies investing in Asia.

The treaty talks are taking place this week and early next month negotiation of a comprehensive Investment Protocol between the two countries will start.

Both initiatives come on the heels of a Closer Economic Partnership (or free trade agreement) signed in March this year.

Revenue Minister Peter Dunne earlier said Hong Kong's law reforms would allow full information exchange for tax purposes when he announced the double taxation

talks in March. Double taxation agreements help facilitate trade and investment between countries by preventing businesses being taxed twice on income earned in the other country.

Arran Boote, an executive member of the Hong Kong New Zealand Business Association (HKNZBA) and international tax director of accounting firm William Buck, said this is a welcome development.

"It will help clarify the position of many dual residents and will also further encourage investment into New Zealand through lowering withholding tax rates," Mr Boote said.

"And very importantly, it has significant implications for any NZ company when considering their pan Asia structure too.

"New Zealand has been and continues to be an attractive investment market for Hong Kong residents. The rate of withholding tax has been the one negative factor influencing those decisions and the double tax agreement will remove this."

Mr Boote said New Zealand has long had a double tax agreement with Singapore, which has led many New Zealand companies to base their pan Asia strategy via Singapore.

But he said Hong Kong had many advantages over Singapore, from repatriation of profit, overhead cost and for entry into the China market perspectives in particular.

"Hong Kong, in its own right, is an important export market for New Zealand goods and services."

nikloeten@nbr.co.nz

Hong Kong Financial News December 6, 2010

Hong Kong signs DTA with New Zealand

On December 1, 2010, a bilateral double taxation agreement (DTA) was signed between Hong Kong and New Zealand. The treaty was signed in Auckland by Hong Kong's Financial Secretary, John C Tsang, and New Zealand's Deputy Prime Minister and Minister of Finance, Bill English.

Without the double taxation agreement, the profits of Hong Kong companies doing business in New Zealand may be taxed in both countries if the income is Hong Kong sourced. The agreement allows avoiding double taxation; so any New Zealand tax paid by the companies will be allowed as credit against the tax paid in Hong Kong in respect of the income, subject to the provisions of the tax legislation of Hong Kong.

It should be noted that the DTA incorporates the latest Organization for Economic Cooperation and Development (OECD) international standards on the exchange of tax information.

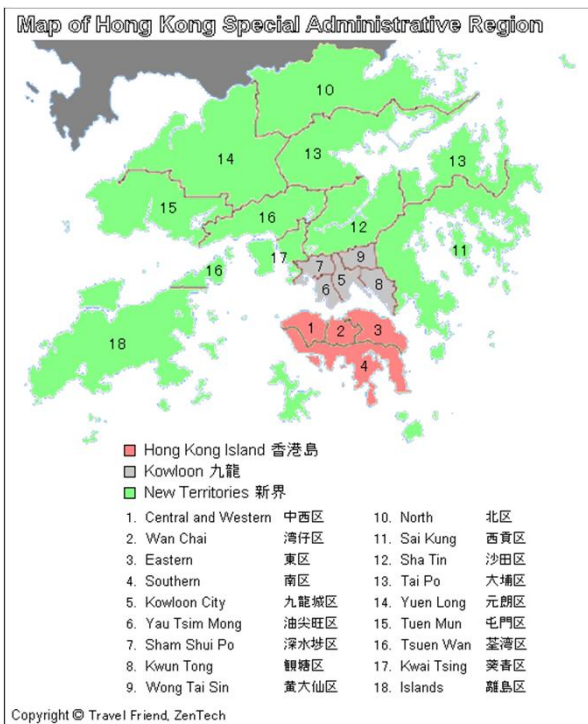
It is the 17th comprehensive DTA concluded by Hong Kong with its trading partners. The 16th Hong Kong's DTA signed with Japan was described previously.

Signing the agreement was welcomed by Tsang as it is strengthening the bilateral relationship by encouraging the flow of investment and talents between Hong Kong and New Zealand.

The agreement will come into force after ratification procedures are completed on both sides.

Overview of Presentation

- Introduction to seminar
- HKSAR's emerging DTA program
- New Zealand's approach to DTA negotiation
- An overview of the HKSAR-NZ DTA
- Comparing the HKSAR & NZ DTA approaches
- Concluding observations



Introduction

- Double taxation traditionally occurs when a taxpayer is taxed twice on the same income by two jurisdictions (source jurisdiction & residence jurisdiction). Relief is usually made on a unilateral basis (domestic laws) or a bilateral basis (DTAs).
- HKSAR is actively establishing a network of comprehensive DTAs with its major trading and investment partners (over 20 agreements have been reached – not all are in force).
- Where no comprehensive DTAs exist HKSAR has over 25 agreements for avoidance of double taxation on airline income, 6 on shipping income (plus 2 agreements combining two areas).
- HKSAR is a destination for trade and investment, and seen as an attractive entry for many countries into the wider South East Asian economies. Also HKSAR-NZ Free Trade Agreement.
- HKSAR is mounting a serious challenge to Singapore (with over 60 DTAs), as a location to locate holding companies.

HKSAR's emerging DTA program

- Prior to 2010 HKSAR had a comprehensive DTA with only 5 jurisdictions (Belgium, Thailand, Vietnam, Luxembourg & PRC).
- 12 DTAs were negotiated in 2010 (this includes NZ). A further 5 commenced negotiation in 2010 or early 2011.
- The major motivation is the January 2010 legislative enactment empowering the HKSAR Inland Revenue to obtain information requested by a DTA partner regardless of whether the HKSAR IRD has a domestic tax interest in the information.
- Protections for HKSAR taxpayers to be informed of the proposed exchange and ability to challenge have been put in place.
- Ratification of DTAs under this new process is steadily being completed with most of these DTAs yet to come into effect.
- HKSAR is seen as a desirable location for PRC investments and Singapore for the rest of Asia – raises issues of cost & efficiency.

HKSAR's emerging DTA program - 2

- **Consider HKSAR's tax regime (key aspects):**
 - Corporate tax rate of 16.5 percent;
 - Purely territorial tax system (foreign-source income tax exempt, even if paid into HKSAR);
 - Relatively low MTRs on individual income (on tier basis);
 - One level of taxation of profits at corporate level (shareholder dividends not taxable);
 - No withholding tax levied on interest or dividends paid to non-residents;

HKSAR's emerging DTA program - 3

- 4.95% withholding tax levied on royalties paid to non-residents (a rate of 16.5% or 15% applies on royalties paid to an affiliate corporate entity or individual, respectively if the relevant intellectual property was formerly owned by an entity carrying on a business or trade in HKSAR);
- No capital gains tax;
- No VAT or goods and services tax; and
- Ability to carry forward losses indefinitely (but no carry-back provision).
- See further M Littlewood (2011) *TNI* and *Taxation without Representation* (2010).

HKSAR's emerging DTA program - 4

- **Key areas included in HKSAR's DTAs:**

- Scope of DTA;
- Taxes covered;
- Definition of permanent establishment;
- Dividend income;
- Interest;
- Royalties;
- Income from employment;
- Directors' fees;
- Airline or shipping profits;

HKSAR's emerging DTA program - 5

- Business profits;
- Right to tax gains;
- Government payments;
- Income from immovable property; and
- Tax credit.
- Of methods to relieve double taxation HKSAR uses *allowance of a tax credit*.

New Zealand's Approach to DTAs

- Useful background: Smith (2010) *NZJTL*; Smith and Sawyer (2011) *JATTA*; Smith and Sawyer (2012) *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties*.
- NZ since joining OECD has used the OECD's model for basis of treaty development, not the UN Model. In some instances NZ departs from the OECD model.
- NZ has a 'traditional' OECD member tax system with the exception of a CGT and a 'pure' VAT (GST).
- NZ has 37 DTAs, 35 of which are in force.
- NZ Government's view is to have a modest size network of (40-50 – like US and Japan) rather than around 100 (like UK and Canada).

New Zealand's Approach to DTAs - 2

- Sawyer (2011): **NZ's strategy recognises DTAs come at a cost:**
 - Forgone revenue,
 - Lock in positions affecting tax policy,
 - Interpretations vary,
 - Must update as change OECD model/negotiate new treaties.
- DTAs must be meaningful to NZ:
 - Have significant economic relationship,
 - Real double tax issues must exist,
 - Advantage for information exchange.
- Will undertake cost/benefit analysis to prioritise negotiations.

HKSAR-NZ DTA

- 17th HKSAR DTA and 37th NZ DTA. Expected to boost cross-border trade and investments.
- Negotiated & signed in a few months – extremely quick.
- HKSAR is NZ's 9th largest export market.
- Follows Closer Economic Partnership – HKSAR's Free Trade Agreement with NZ came into force 1 January 2011 – first one after its CEPA with PRC.
- Similar to other recent NZ DTAs (incl. 2009 Australia-NZ DTA).
- Expected to come into force in 2011: HKSAR gazetted order in May 2011 (Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income (New Zealand) Order 2011).
- NZ expects to ratify by end of 2011 (National Interest Analysis released August 2011).

HKSAR-NZ DTA - 2

- Key aspects:
 - Resident taxation (individuals & companies – differs to account for HKSAR tax system);
 - Avoidance of double taxation (especially for NZ tax residents);
 - Exemption for international shipping;
 - Articulation of PE rule;
 - Tax credit provisions; &
 - Latest information exchange provisions.

HK SAR-NZ DTA - 3

■ Withholding Tax Rates on Dividends, Interest and Royalties under the NZ-HK DTA

Income

Interest

Withholding tax rate under DTA

10%

0% – interest paid to a financial institution (third party loans only and Approved Issuer Levy (AIL) must be paid or be payable)

Dividends

15% – Less than 10% shareholding

5% – 10% to 50% shareholding (if the recipient is a company)

0% – 50% or greater shareholding and other requirements met (e.g. recipient is a company and listed and primarily traded on a recognised NZ or HK Stock Exchange)

Royalties

5%

HKSAR-NZ DTA - 4

■ National Interest Analysis: Advantages

- Foster bilateral economic activity (such as services, trade and investment). DTA will complement the CEPA and investment protocol to that Agreement;
- Reduce compliance costs & ensuring availability of low headline withholding tax rates;
- Reduced withholding tax rates for dividends that are not fully-imputed & royalties;
- Reduce the cost of importing capital;
- Prohibit discriminatory taxes;

HKSAR-NZ DTA - 5

- Provide a mutual agreement procedure to facilitate the resolution of tax disputes;
- Eliminate need for individuals engaged in certain short-term, income-earning activities to pay tax & claim that tax against the tax liability in the individual's home jurisdiction;
- Provide an equitable framework for sharing the cost of relieving double taxation; &
- Eliminate the need for New Zealand to provide credits for certain foreign taxes.

HKSAR-NZ DTA - 6

- **Disadvantages:**
 - Provides that: (a) certain lump sum retirement payments from HKSAR will be taxable only in HKSAR; and (b) the taxing right on some periodic government service pensions will be shared by both jurisdictions; &
 - Potential treaty-shopping concerns - since it is a significant international financial centre, & has a territorial-based tax system, HKSAR is a favoured location for non-residents to establish companies.
- HKSAR-NZ DTA is a compromise between the starting positions of NZ and HKSAR - NZ's key negotiating objectives were secured. Key area of compromise - taxation of pensions.

HKSAR-NZ DTA - 7

- Officials satisfied potential advantages to NZ outweigh potential disadvantages.
- Major advantage is to avoid double taxation for NZ resident taxpayers. Minimal cost in lost revenue (\$NZ0.5m).
- Various changes to NZ domestic law via treaty override.
- No social, cultural or environmental effects.
- Compliance costs for businesses expected to reduce.
- Limited consultation undertaken – other NZ Govt Departments/Ministries, and HCSB prior to negotiations.
- Order in Council to be passed before the end of 2011.

Comparison of HKSAR and NZ DTA Approaches

- HKSAR: is in rapid expansion phase with change in philosophy following January 2010 legislative amendment.
- Keen to be a major entry point for South East Asia, especially for entry to PRC – establishing a treaty network is a key element.
- NZ is a key partner – first FTA outside of that with PRC.
- NZ: has been steadily increasing its DTA network over last 4-5 years – grow to 40-50 agreements with its major trading partners.
- There must be clear benefits to NZ if it will negotiate a DTA – will undertake cost/benefit analysis.
- NZ largely follows the OECD Model Convention.

Concluding Observations

- A unique aspect of HKSAR's DTA program is that NZ is the only country currently outside of PRC to have a FTA as well.
- HKSAR is becoming a major alternative/complement to Singapore as a hub for investment into South East Asia.
- NZ has a much larger DTA network - aim is 40-50 agreements.
- While following the OECD Model there are some differences to account for the tax system in HKSAR and NZ's negotiating position on several key articles in the HKSAR-NZ DTA.
- The HKSAR-NZ DTA is one from both HKSAR and NZ perspectives to be mutually beneficial for the governments and businesses. It should facilitate trade and investment flows.
- HKSAR has ratified the DTA – NZ has yet to do so but should before the end of 2011.